



Texas Lottery Commission Internal Audit

An Internal Audit of

Scratch Ticket Game Closing Processes

August 22, 2018

Report #18-006

Prepared by:



This report provides management with information about the condition of risks and internal controls at a specific point in time. Future changes in environmental factors and actions by personnel will impact these risks and internal controls in ways that this report cannot anticipate.



INTRODUCTION

McConnell & Jones LLP (MJ) serving as the outsourced internal audit function (Internal Audit) for the Texas Lottery Commission (TLC) performed an internal audit of the scratch ticket game closing process. We conducted this audit in accordance with generally accepted government auditing standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our observations and conclusions based on our audit objectives.

Pertinent information has not been omitted from this report. This report summarizes the audit objective and scope, our assessment based on our audit objectives and the audit approach.

Objectives and Scope

The purpose of this audit is to review the business process and internal controls related to the Texas Lottery Commission’s instant game closing process to determine if management controls are in place to achieve the business objectives and comply with TLC’S policy and procedures and legislative statutes.

Internal Audit examined the following business processes during the audit process.

- ✓ The management framework supporting the scratch ticket game closing process.
- ✓ The business processes related to the closing of instant games.

The audit period covered September 1, 2017 through June 30, 2018. However, some test procedures were performed as of the date of fieldwork. This work product was an evaluation at a specific point in time that cannot address the inherent, dynamic nature of subsequent changes to the process/procedures reviewed.

Audit Procedures Performed

We conducted interviews, reviewed written procedures, and performed audit testing of the scratch ticket closing process. Eighty-three scratch ticket games were closed between September 1, 2017 and July 27, 2018. We selected 14 scratch ticket games, 17 percent of the scratch ticket games that were closed, to determine compliance with TLC’s policies, procedures and assessed internal controls.

Conclusion and Overall Internal Control Rating

The Texas Lottery Commission’s internal control environment governing the closing of scratch ticket games is effective and working as intended. The current internal control environment ensures the agency meets its business and compliance objectives related to the closing of scratch ticket games. The scratch ticket game closing process and the business criteria used to determine the scratch ticket game closing timing was internally developed and serves as the industry’s benchmark process adopted by other state lottery commissions. The audit work completed identified no reportable findings.

This audit resulted in an overall internal control rating of **Effective** based on the business processes reviewed. **Figure 1** describes the internal control rating.



Internal Control Rating

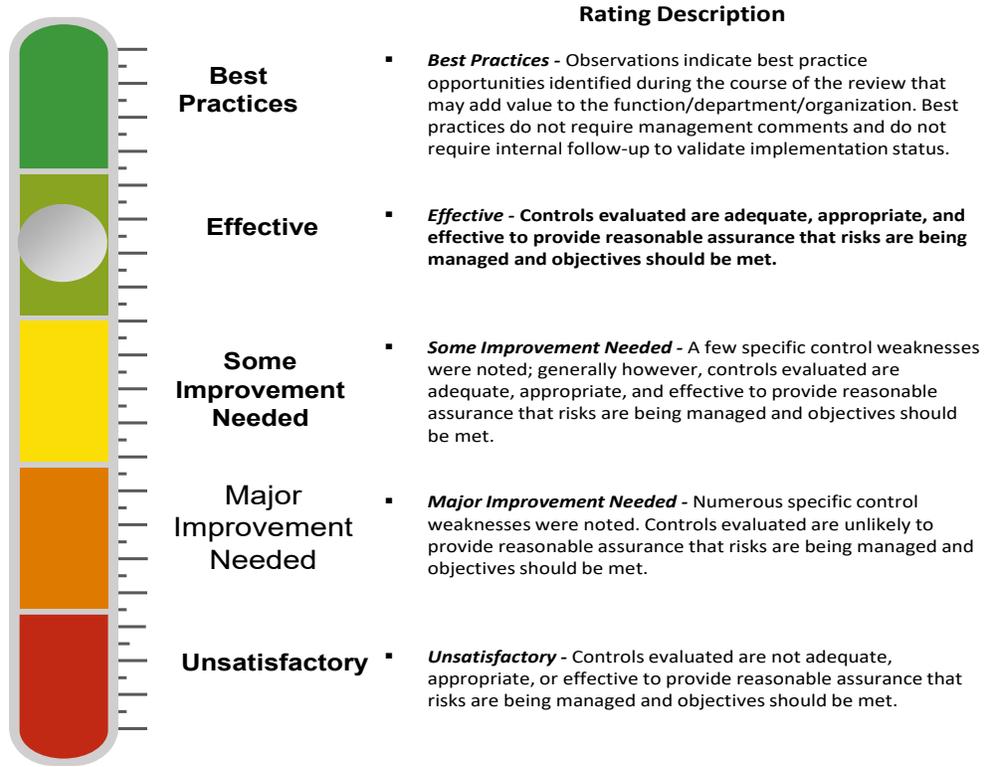


Figure 1 Internal control rating description.

Acknowledgement

We wish to thank all staff involved in this audit for their professionalism and positive outlook towards the assessment of their operations. The completion of this audit was due to their efforts and responsiveness to our requests.

BACKGROUND

Sales of lottery games contribute over \$1 Billion annually to the Foundation School Fund, Texas Veterans Commission and the state’s General Revenue Fund. The Texas Lottery Commission scratch ticket games represents over 77 percent of TLC’s annual sales. TLC’s goal is to ensure that new scratch ticket games with available prizes are always accessible to retailers for players to purchase. TLC strives to ensure that older scratch ticket games with low sales or awarded prizes are not consuming limited retailer space and ticket dispensers.



The scratch ticket game closing processes developed by the Texas Lottery Commission has become a model that is adopted by other state lotteries. **Figure 2** provides an overview of the scratch ticket game life cycle.



Figure 2 Scratch ticket game life cycle.

Scratch ticket games are closely monitored and evaluated against established criteria to determine when a game should be closed. Scratch ticket game performance is evaluated based on the number of weeks the game has been available for sale, the rate of sales, and ticket inventory in the warehouse and at retailer locations. Scratch ticket game closing criteria includes the following:

Mature Games

- ✓ Over 85% sold (settled packs)
- ✓ Little to no warehouse inventory remaining
- ✓ Sales slowdown due to a lack of field inventory

Slow Moving Games

- ✓ Under 85% sold (settled packs)
- ✓ Sales are slower than a typical game at the same price point and produced print quantity
- ✓ Must be on the market for a minimum sales period

Other Reasons



- ✓ Business reasons
- ✓ All top prizes claimed

TLC’s Scratch Game Coordinator reviews scratch ticket sales information and determines if a scratch ticket game meets the stated criteria to determine if the game should be closed and replaced with a game that will provide a higher sales return. Once this review process determines that a game should be closed, the Scratch Ticket Game Coordinator completes the required documents and obtains authorization.

Once the scratch ticket game is approved for closing, there are four key dates that are followed. **Figure 3** provides an overview of these dates. It is important to note that if a game needs to be closed immediately to maintain the security and integrity of lottery games the game would be “called” immediately with no pre-call notice.

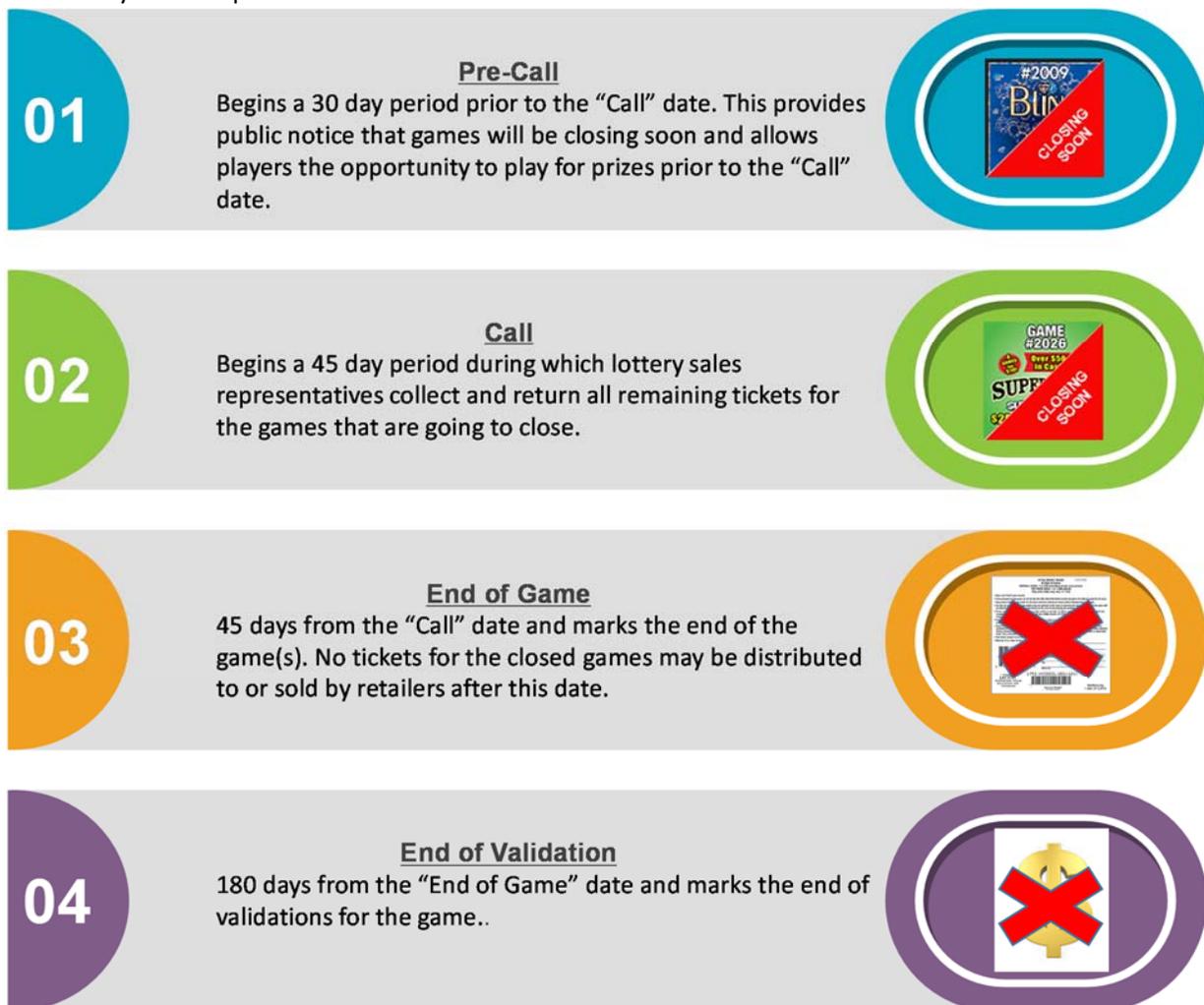


Figure 3 Scratch ticket game closing dates.

TLC uses the Scratch-Off Maintenance (SOM) system to track scratch ticket game closing dates. TLC notifies the public of game closing information through various outlets including media advertisements,



the TLC website and mobile application, retailer locations, or TLC publications. This information may show the ticket artwork or name of the ticket, and may include any of the following information: the official close of game date, the end of validation date, information on how to claim a prize, the odds of each game, and the Texas Lottery Customer Service Hotline number.

Sales representatives collect all remaining tickets from retailers and returns them to the scratch ticket warehouse for confirmation, storage and eventual destruction. All scratch ticket games closed are marked as closed in the gaming system 45 days after the call date. This code prevents tickets from being sold.

Semi-annually a game close report which details the games which were closed in the previous six months is provided to the Legislative Budget Board. This report details the date on which game close processes began (Call Date) and the date on which sales ended (Official End of Game Date).

DETAILED AUDIT OBJECTIVES, OPPORTUNITIES AND RECOMMENDATIONS

This section of our report provides the detailed audit objectives and a discussion of the controls and processes in place along with our control effectiveness conclusion and recommendations. It is important to note that we found no reportable conditions and one opportunity for TLC to improve efficiencies and controls.

Audit Objective #1: Determine if the Texas Lottery Commission’s management framework effectively maintains the processes related to closing scratch ticket games.

Does the agency have an effective process to determine which games should be closed? Does the agency have formalized policy and procedures that govern scratch ticket game closings?

Audit Conclusion

TLC’s governance processes effectively supports the internal control environment related to scratch ticket game closings. The internal processes developed to monitor scratch ticket game performance and determine game closing timing is maintained and executed by seasoned staff is effective and working as intended. Furthermore, this process has become a standard used by other state lotteries and demonstrates TLC’s commitment to ensuring the security and integrity of lottery games.

The scratch ticket game closing processes use specific key metrics to determine game closing timing. These include an effective monitoring and approval process that includes appropriate segregation of duties. The process also includes documenting the communication of games closed to the public and retailers.

The agency has ensured that the knowledge achieved through this developed process is institutionalized and will remain with the agency even if a key process owner is no longer in the position for any reason. This is achieved through effective documentation in the form of written policy and procedures and standard templates related to the monitoring and closing of scratch ticket games.





The written policy and procedures define the processes and the roles, responsibility and authority of the process owners. This ensures that the determination of closing scratch games is completed in a consistent and complete manner. We also noted the policy and procedures are maintained based on the agency policy and procedures guidelines with ease of access and proper approvals.

Audit Recommendation #1

No recommendations are made for the governance processes of scratch ticket game closing.

Audit Objective #2: Determine if the Texas Lottery Commission has developed a systematic process that uses key information, effective oversight, and communication of scratch ticket game closings.

Has the agency developed a systematic process to determine which scratch games are closed? Does the process include key metrics used to measure performance ensuring the agency’s business objectives are met? Does the agency process ensure proper oversight ensuring closed games do not affect scratch game revenue? Does the agency ensure transparency in the communication of closed games?

Audit Conclusion

Internal controls for ensuring compliance with TLC’s scratch ticket game closing policy and procedures are effective and working as intended. Our audit testing of the process noted 100 percent compliance with the documented and observed processes related to determining when scratch ticket games should be closed.

The agency developed and uses established criteria to determine which scratch ticket games should be closed to ensure ticket inventory in retailer game dispensers does not contain scratch ticket games that no longer provide optimized revenues or have had top level prizes awarded.

TLC’s Scratch Ticket Coordinator uses the following documentation to conduct an analysis of active scratch ticket games to determine which ones should be closed:

- A. Sales/Inventory Summary Report (“Da Vinci” report)
- B. Average Weekly Dollar Sales at 85 percent Sell Through
- C. Average Number of Weeks for 85 percent Sell Through
- D. Zero Top Prize Report

TLC’s Scratch Ticket Coordinator’s analysis of this information is documented on the Scratch Ticket Game Closing Analysis Summary Report which also documents the approval to close the scratch ticket game or management’s reason for not closing the game. The 85 percent sell through is based on business experience and has been proven to be an effective metric.

Once the games have been closed the state requires that the closed games are reported to the public and regulating agencies. We confirmed that this process was also performed.



Audit Recommendation #2

No recommendations are made. Our audit testing indicates 100 percent compliance with established policies and procedures.

Audit Objective #3: Determine if the scratch ticket game closing process efficient to allow maximum use of limited resources.

Are automated systems in place to facilitate the scratch ticket game closing processes? Are the current scratch ticket game closing processes efficient?

Audit Conclusion

Although we determined that internal controls over the scratch ticket game closing processes are effective we also noted that the analysis is a manual process.

The scratch ticket game closing analysis follows a systematic process with a strong internal control environment performed by agency members who either developed the process or are tenured. Our audit procedures applied indicates that a consistent and effective procedure is used to determine the closing of scratch games.

The one area of process improvement that should be considered for automation is the manual process used to analyze the list of active scratch ticket games. TLC’s Scratch Ticket Coordinator currently reviews each active game and manually determines if the scratch ticket game meets the criteria to be considered for closure.

Our walkthrough of the process noted that this is a time consuming event that could be improved through system integration and exception based reporting. The exception based reporting would provide the Scratch Ticket Coordinator with the scratch ticket games that meet the initial criteria for closing but would still be evaluated and approved to ensure business experience not captured by a data script is also conducted.

Audit Recommendation #3

Consider automating the scratch ticket game analysis process to ensure the continued efficiency in the evaluation process and minimize potential errors that could occur if the process is completed by individuals with less business and process experience.

TLC’s staff currently performing the review is tenured and has the expertise needed to ensure a proper evaluation is completed which limits the possibility of human error. Automation of this process based on the criteria for closing scratch games will reduce the risk for improper analysis and conclusions.